

Remarks by
Tony T. Brown, Director

Community Development Financial
Institutions Fund (CDFI)

To the

Annual Conference
of
The Community Development
Venture Capital Alliance

Wyndham Orlando Resort
Orlando, Florida

Tuesday, March 5, 2002

CDFI
fund

COMMUNITY
DEVELOPMENT
FINANCIAL
INSTITUTIONS
(CDFI) FUND

March 5, 2002

Contact: Karen Mocker
(202) 622-8401

**Remarks by Tony T. Brown, Director
Community Development Financial Institutions Fund (CDFI)**

To the

**Annual Conference of The Community Development Venture
Capital Alliance
Wyndham Orlando Resort, Orlando, Florida
Tuesday, March 5, 2002**

Introduction

Thank you, Kerwin Tesdell, for that kind introduction. Please allow me to take a minute to express my gratitude and thanks to you in front of your membership. Kerwin has been a tireless advocate of your interest. He's everywhere – I first met Kerwin with the NMTC Coalition. Following that, I met with the CDFI Coalition. And, he was there, too.

My first interface with the industry was the Community Development Venture Capital Alliance. I was interviewed for your newsletter. I heard early on about your interests. I learned quickly about the importance of the New Market Tax Credit Program to your organization.

Kerwin asked my help in coordinating the rollout of New Markets Tax Credit with SBA's New Market Venture Capital Fund. He was concerned that the delays in releasing the IRS guidance on New Markets would have an adverse impact on NMVCs' ability to raise equity and meet SBA's deadline for equity capital.

I assured Kerwin he had my support. Our mutual goal is to increase the flow of capital into low-income communities. If this is the goal of the SBA, then we should support their efforts too. We met with SBA officials and gave them a progress briefing. We met with Tax Policy in Treasury and shared CDVCA's concerns. I understood early on as a new political appointee that interagency cooperation would be critical if the Fund is to succeed in its efforts. The presentation was easy. We need every tool possible to improve the economic health of our nation's most underserved areas.

The outcome was just as easy. As a result of our collective efforts, the IRS agreed to offer a "look-back" period through which NMVCs and other potential recipients of New Market Tax Credit allocations could offer the tax credits to their investors. This look-back period applies to any qualified investments received on or after April 20, 2001. IRS published notification of this decision last November – over a month prior to releasing its NMTC regulations – so that NMVC firms could alert potential investors of this decision right away. We

recognized how important this issue was to the community development venture capital industry, and we were glad to help you achieve a desirable outcome. I credit Kerwin for bringing this matter to my attention.

Now, Kerwin, we need your help again! I know CDVCA has been instrumental in encouraging organizations to register as Community Development Entities or CDEs. I am pleased to report that today over 170 organizations have been certified as CDEs. Three of 174 CDEs are SSBICs. We need your help in getting more groups registered. We need you to push NMVCs and SSBICs to get registered as CDEs.

It gives me great pleasure to be here to represent the Department of the Treasury and the CDFI Fund to address your organization; and to welcome you to my adopted home state - Florida. Let me also add, on behalf of every chamber of commerce in the sunshine state, we hope that you invest millions of venture capital dollars in this great state.

I have spent 20 years in banking. Ten of these years have been in community development in the state of Florida. I know the importance of development venture capital. I understand how mezzanine financing can move a deal from declination to approval. I empathize with minority entrepreneurs who have vision and expertise in a particular field and are willing to take risk but can't seem to overcome a financial institutions requirement for equity or collateral.

My heart aches when I see Americans living in poverty, buildings boarded up and homes dilapidated. This is America. No one should feel despair or disenfranchised. America is still the land of opportunity and I am honored to stand in front of you today to say thank you for raising socially conscious capital. Keep up the good work!

We cannot overstate the importance of the NMTC Program and our hope that you will be able to use this program to attract equity in your valuable venture capital funds. We commend you for viewing your investments as providing twice the impact to the bottom-line – investments that generate financial returns and investments that enrich our communities.

Treasury Secretary Paul O'Neill has made creating jobs and improving living standards of people everywhere the standard by which to measure the impact Community Development Entities (CDEs) and Community Development Financial Institutions (CDFIs) have in the marketplace. Secretary O'Neill believes that our job in government is to continuously improve the framework of our economy. He has set a high standard and expectation for the CDFI Fund to help Treasury achieve this mission in low-income communities and by targeting populations that have historically been underserved.



By offering a tax credit, the New Markets Program encourages private investment in underserved communities in an unprecedented manner. If the program is embraced by investors, it will be a significant source of new, patient capital that will help to stimulate new industries and entrepreneurs, to diversify the local economy, and to generate new jobs in low-income communities.

Let me put a face on the NMTC program for you. It is \$15 billion in tax credits designed to spur economic development in low-income communities. Yet nearly 24,600 census tracts in the United States qualify for NMTCs. That's nearly 40 percent of all census tracts, representing 36 percent of the population, where in nearly 91 million people reside. There can be no contest that the New Markets Tax Credit program is seriously needed throughout the nation. The directive at Treasury has been quite pointed – successfully implement the NMTC program this year!

I'd like to spend the next 15 – 20 minutes talking about (1) developments at the Fund; (2) a briefing on the NMTC program; and (3) some things you might want to consider if you are planning to capitalize your venture capital fund or pool by utilizing NMTCs. I hope, following this, we can engage in a dialogue of questions, answers, and ideas from you.

(1) Developments at the Fund **Vision and Change**

First, let me talk vision and change. As you know, our vision at the Fund is to have an America in which all people have adequate access to credit, capital, and affordable financial services. My vision for the Fund is to grow our organization as the nation's leading vehicle and best practice government agency for financing economic and community development activities in low-income areas, distressed and underserved communities.

In response, we have strategically taken a step back in order to leap forward with an ambitious plan of service to America. That first step has been to develop a new organizational structure that is designed to help build your capacity to achieve such results. Some of what we aspire to is placing a higher accountability upon ourselves here at the Fund to complete application reviews, make awards, and close and disburse these awards in a more timely manner. We also are putting systems in place to ensure that we are targeting awards in the areas of highest need with organizations that can help us to achieve the greatest impact.

We will apply these basic principles to the NMTC program from the start. An important new addition to the staff is Linda Davenport, who is the manager for the New Markets program. Linda comes with a long work experience in the Low Income Housing Tax Credit program, has a legal background, and brings many years' experience as a practitioner and as an equity investor, so she will def-

initely add a valuable and fresh perspective to the development of the New Markets program.

(2) Brief NMTC Overview

To recap briefly, the New Markets Tax Credit Program is designed to help spur economic growth in urban and rural communities across the country. Briefly, here's how NMTCs will work:

Tax credits are allocated for investments into a Community Development Entity (CDE), certified by the Fund;

To qualify as a CDE, the entity must have a mission of community development and demonstrate accountability to the low income communities served (The Fund is allowing multiple, related entities to apply for certification under a single application. CDEs will be allowed to sub-allocate tax credits to subsidiary entities, and it is not necessary that they identify each of these subsidiaries at the time of their initial application for the tax credits).

A CDE applies for an allocation of NMTCs.

The CDE uses its allocation of NMTCs to raise equity from private investors.

Investors can receive NMTCs worth 39% of the invested amount over the life of the credit. (5% in the first three years; 6% in the subsequent four years).

Investors need to make their investments in a CDE, certified by the CDFI Fund.

The proceeds from these investments must be made in Qualified Low-Income Community Investments (QLICs).

There are four types of QLICs:

- 1) Investments in or loans to qualifying low-income community businesses;
- 2) Training or technical assistance to businesses or entrepreneurs in low-income communities;
- 3) Investments in or loans to other CDEs; and
- 4) The purchase of qualifying business loans from other CDEs.

\$15 billion in equity to which NMTCs may be claimed will be available over the next six years. We expect to allocate up to \$2.5 billion in such equity in calendar year 2002. In seminars at the conference, Fund staff will discuss the program in greater detail.



The NMTC staff has been working diligently to finalize the NOAA (Notice of Allocation Availability) and the application process. Most exciting, we will be accepting applications electronically, another efficiency measure to get this program out on the street as soon as possible. We anticipate release to the Public by April 30th.

We encourage you to check out our website on a regular basis for updates regarding the NMTC. Soon, you will see the NOAA and the application package appearing there! And if you haven't done so, check there, too, for how to become a CDE. So far, as mentioned, we have certified over 170 CDEs!

The New Markets staff also has been working closely with the IRS to make sure that the process we are creating matches the rules to govern the distribution of tax credits.

Compliance Monitoring and NMTC

Let me share with you how important I believe it is to clearly define what may cause a recapture event. If the NMTC program is to be successful, investors must be very comfortable and clear on what could trigger recapture. As a reminder, the tax credits may be recaptured from the investor if:

- 1) The CDE fails to invest, either initially or upon subsequent returns of capital, substantially all (generally 85%) of the investor dollars into qualifying activities;
- 2) The CDE fails to meet the requirements (related to primary mission and community accountability) relating to certification as a CDE; or
- 3) The investment is redeemed by the CDE prior to the conclusion of the seven-year credit allowance period.

We are working very closely with IRS in developing clear guidelines and outlining our respective roles and responsibilities. As part of this process, they will aid the Fund in developing an entirely electronic reporting and compliance system – so that all CDEs will be submitting uniform compliance documents, customized to the types of investments in which they are engaged.

For its part, the role of the Fund is charged with the implementation of the tax credit program. That means developing and setting policy that will govern the certification of CDEs, and the competitive application process for tax credit allocations.

It means administering the process to determine which groups will receive awards each year. And it means overseeing the use of tax credit investments through excellent compliance monitoring to ensure that low-income and economically distressed communities are served.

IRS, on the other hand, is responsible for developing the regulations that govern the use of tax credit allocations. They published implementing regulations on December 26, 2001 addressing, among other things: how the proceeds from the tax credit allocations must be used; what qualifies as an eligible investment; and what events will trigger a recapture of the tax credit.

Please familiarize yourself with these rules and share them with your investors. A copy of these regulations are available on the Fund's website.

I would also like to point out that these rules are still in a temporary stage. The IRS public comment period closed last week, but we've been told that they'll review comments that come in after the deadline. So I would encourage you to contact IRS if you have significant comments or concerns regarding the regulations.

(3) Issues in Using the NMTC Program for CDEs

I wanted to spend some time talking about how New Markets Tax Credits can open up opportunities for you, and deal with the challenges presented by being "development venture capitalists."

- a. **The Double Bottom-Line.** One of the typical things said about DVC is that it works to achieve the "double bottom line." Your organizations work to ensure that the deals you invest in are profitable, and yet, still accomplish important "human" end results: more jobs, better quality jobs, increased wealth for low-income individuals, better quality of life, and capital access to groups who have historically not participated in traditional venture capital funds.

Your challenge is how to straddle the social purposes that under-gird your mission, while still having the ability to attract investors.

We will need your assistance and cooperation in helping us design a process that will measure impact and sustainable economic growth from the funds you raise using NMTCs.

- b. **Investor Fit.** Who will be the right kind of investors for this program? There are two issues to tackle under this heading. One is what traditional VC investors look for, and the other is how DVCs will make the conversion from non-taxpaying pool investors, to tax paying investors, who are enticed by the tax credit.

Many regular VC investors want, not surprisingly, to invest in deals where rapid growth is possible, and they want proximity to their investments for monitoring capability. They make larger investments, in general, than DVCs do, and also would like to know clearly that the exit strategy is in place at the time of



investment. Many of their investments rely heavily on personal relationships that have been built, and the assessment of management oftentimes is the deciding factor to invest. It is just these kinds of requirements that have precluded investment in low-income and rural areas.

Our basic premise for the NMTC Program is that investors will get an additional return each year for seven years in the form of a tax credit, and their money will go directly into highly economically distressed areas. We're hearing that the tax credit, in itself, is not enough. We know that the deal matters.

A TAX CREDIT THROUGH CDEs CAN HELP!

1. You will be the middleman that will make their large investments in your CDE work in a variety of smaller deals that they would never have the time or interest in which to participate.

A TAX CREDIT THROUGH CDEs CAN HELP!

2. You will be the surrogate monitor for the investor, providing skilled technical assistance to the investee businesses and bringing a proven track record of stable, experienced management to oversee these companies.

A TAX CREDIT THROUGH CDEs CAN HELP!

3. You will develop the personal relationship on both ends. You already have it with the businesses needing patient capital, and you'll be developing it with your investors.

You'll make it easy on them, so why wouldn't they invest?? The important thing is that New Markets will give you the tool that allows you to have the conversation with tax-paying investors. If Congress wanted to simply provide a credit for investments into low-income areas then the credit would be direct.

Instead, these investments occur through CDEs, empowering you to provide the expertise and technical assistance needed to make these deals work in low-income communities and to have low-income residents as members of your boards. As the program progresses, we will need to hear from you about what works as well as what doesn't. And where it's not working, the commitment and collaboration to fix it!

CONCLUSION

In talking with several trade groups over the course of the fall and winter, I have also learned that CD venture groups have been lining up investors. "That's very good"

We need the NMTC Program to be the impetus to increase the flow of private capital into low-income communities. Direct subsidies from the Federal government alone will not do it. We hear that NMTCs may take time before investors are comfortable with using it as a tool.

We, in all honesty, do not have the luxury of time. President Bush has made the nation's economic recovery a top priority. The President requested an economic stimulus package to reduce the tax burden on job-creating investments. The Senate has voted to extend unemployment benefits, but have yet to vote on the President's stimulus packet.

While the economic stimulus package debate continues in Congress, we have a head-start and a new tool in the community development finance field. Like many of you, I was anxious to ride the stock market wave of the dot-coms and the tele-coms. Now, we have an opportunity today to bring in a new era: that of the low-coms.

Your funds have been on the leading edge in providing assistance to businesses that create jobs for low-income people. Your funds have helped revitalize low-income communities. The market opportunity is tremendous and the commitment from Treasury to see this program succeed is high.

In 10 years time, when we look back, we hope to say the NMTC Program put significant amounts of private sector capital investment to work in the areas where it was needed most. We know that you too share this vision. Thanks for having me. I look forward to working with you.

Thank you very much for your attention, and now, please share with me your thoughts and questions.

